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IN THE MATTER OF THE JOINT NOTICE OF INTENT BY VERIZON COMMUNCIATIONS, INC., AND MCI, INC., ON BEHALF OF ITS REGULATED SUBSIDIARIES	DOCKET NO. T-01846B-05-0279 T-03258A-05-0279 T-03475A-05-0279 T-03289A-05-0279 T-03198A-05-0279 T-03574A-05-0279 T-02431A-05-0279 T-03197A-05-0279 T-02533A-05-0279 T-03394A-05-0279 T-03291A-05-0279

NOTICE OF FILING RESPONSIVE TESTIMONY

Staff of the Arizona Corporation Commission hereby files the Redacted Responsive Testimony of Elijah Abinah and Armando Fimbres of the Utilities Division, in the above-referenced matter.

The Unredacted version of the Responsive Testimony is being provided to those parties who have executed the Protective Agreement in this matter.

RESPECTFULLY SUBMITTED this 2nd day of September, 2005.

Maureen A. Scott

Maureen A. Scott
Attorney, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Original and thirteen (13) copies
of the foregoing were filed this
2nd day of September, 2005 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Copies of the foregoing mailed this
2nd day of September, 2005 to:

Elaine M. Duncan
Vice President and General Counsel
Verizon California, Inc.
700 Van Ness Avenue
San Francisco, California 94102

Deborah R. Scott
Of Counsel
Snell & Wilmer
One Arizona Center
400 East Van Buren
Phoenix, Arizona 85004

Sherry F. Bellamy
Vice President and Associate General Counsel
Verizon Corporate Services Corp.
1515 North Courthouse Road, Suite 500
Arlington, Virginia 22201

Robert P. Slevin
Associate General Counsel
Verizon Corporate Services Corp.
1095 Avenue of the Americas
Room 3824
New York, New York 10036

Mary L. Coyne
2055 L Street, N.W., 5th Floor
Washington, D.C. 20036

Andrew B. Clubok
Kirkland & Ellis LLP
655 Fifteenth Street, N.W., Suite 1200
Washington, D.C. 20005

. . .

Thomas F. Dixon
Senior Attorney
MCI, Inc.
707 17th Street, Suite 4200
Denver, Colorado 80202

Thomas H. Campbell
Lewis and Roca LLP
40 North Central Avenue
Phoenix, Arizona 85004-4429

Richard B. Severy
MCI, Inc.
Director, State Regulatory
201 Spear Street, 9th Floor
San Francisco, California 94105

Marsha A. Ward
National Director – State Regulatory
Law & Public Policy
MCI, Inc.
6 Concourse Parkway, Suite 600
Atlanta, Georgia 30328

Michael W. Patten
Roshka Heyman & DeWulf
One Arizona Center
400 East Van Buren, Suite 800
Phoenix, Arizona 85004

Karyn Christine

Karyn Christine, Legal Assistant

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION OF VERIZON CALIFORNIA INC., VERIZON SELECT SERVICES, INC., ONE POINT COMMUNICATIONS-COLORADO, L.L.C. D/B/A VERIZON AVENUE, BELL ATLANTIC COMMUNICATIONS, INC. D/B/A VERIZON LONG DISTANCE, NYNEX LONG DISTANCE COMPANY D/B/A VERIZON ENTERPRISE SOLUTIONS, MCIMETRO ACCESS TRANSMISSION SERVICES, L.L.C., MCI WORLDCOM NETWORK SERVICES, INC., TTI NATIONAL, INC., TELECONNECT LONG DISTANCE SERVICES AND SYSTEMS COMPANY DBA TELECOM USA, MCI WORLDCOM COMMUNICATIONS, INC., AND INTERMEDIA COMMUNICATIONS, INC. FOR A PPROVAL OF A REORGANIZATION	DOCKET NOS.T-01846B-05-0279 T-03258A-05-0279 T03475A-05-0279 T-03289A-05-0279 T-03198A-05-0279 T-03574A-05-0279 T-02431A-05-0279 T-03197A-05-0279 T-02533A-05-0279 T-03394A-05-0279 T-03291A-05-0279

DIRECT

TESTIMONY

OF

ELIJAH O. ABINAH

ASSISTANT DIRECTOR

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

SEPTEMBER 2, 2005

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VERIZON CALIFORNIA INC., VERIZON SELECT SERVICES, INC., ONE POINT COMMUNICATIONS- COLORADO, L.L.C. D/B/A VERIZON AVENUE,BELL ATLANTIC COMMUNICATIONS, INC. D/B/A VERIZON LONG DISTANCE, NYNEX LONG DISTANCE COMPANY D/B/A VERIZONENTERPRISE SOLUTIONS, MCIMETRO ACCESSTRANSMISSION SERVICES, L.L.C., MCIWORLDCOM NETWORK SERVICES, INC., TTINATIONAL, INC., TELECONNECT LONG DISTANCE SERVICES AND SYSTEMS COMPANY D/B/A TELECOM USA, MCI WORLDCOMCOMMUNICATIONS, INC., AND INTERMEDIACOMMUNICATIONS, INC.
DOCKET NOS. T-01846B-05-0279, T-03258A-05-0279, T-03457A-05-0279, T-03289A-05-0279, T-03198A-05-0279, T-03574-05-0279, T-02431A-05-0279, T-03197A-05-0279, T-02533A-05-0279, T-03394A-05-0279, AND T-03291A-05-0279

My testimony addresses the proposed merger of Verizon Communications, Inc. ("Verizon") and MCI, Inc. ("MCI") and their respective Arizona subsidiaries identified in the joint Application filed with the Arizona Corporation Commission on April 13, 2005. The testimony reviews the Application, participants, proposed merger, application of the Affiliated Interest Rules, Arizona merger effects, merger benefits and public interest considerations, bonding requirements, outstanding issues and/or obligations, and Staff's recommendations. Staff Witness Armando Fimbres addresses the competitive impacts of the proposed merger in more detail.

Unlike states where Verizon is the dominant or major incumbent local exchange carrier, where there is considerable overlap between Verizon's and MCI's operations, there is almost no overlap in Verizon's and MCI's Arizona operations. Consequently, combining the separate operations of Verizon and MCI would not appear to result in any duplicate operations in Arizona that would require force reductions, the realignment of resources, or adversely affect competition in the various telecommunications markets in Arizona.

When considered by customer class, it appears that enterprise customers and governmental customers will benefit by the presence of a stronger competitor in these markets. The IP and mobile markets in Arizona are also likely to benefit at some point in the future given the Companies' stated focus on these areas. The benefits to traditional mass market local exchange subscribers, however, cannot be adequately quantified by Staff at this time.

Overall, Staff believes that the proposed merger is in the public interest. Verizon's financial resources and strength should benefit MCI investors and customers. The merger should result in a financially stronger combined entity with many more resources and capabilities at its disposal. With respect to other alleged benefits claimed by the Companies and discussed in my testimony, I believe it would be helpful if the Companies in their Rebuttal Testimony would provide more detail on merger synergies including the cost reductions referenced in their initial testimony, the $2 billion dollar investment to be made to MCI's network, and the benefits to mass market customers.

INTRODUCTION

Q. Please state your name and business address.

A. My name is Elijah O. Abinah. My business address is 1200 West Washington Street, Phoenix, Arizona, 85007.

Q. Where are you employed and in what capacity?

A. I am employed by the Utilities Division ("Staff ") of the Arizona Corporation Commission ("ACC" or "Commission") as the Assistant Director.

Q. **How long have you been employed with the Utilities Division?**

A. I have been employed with the Utilities Division since January 2003.

Q. Please describe your educational background and professional experience.

A. I received a Bachelor of Science degree in Accounting from the University of Central Oklahoma in Edmond, Oklahoma. I also received a Master of Management degree from Southern Nazarene University in Bethany, Oklahoma. Prior to my employment with the ACC, I was employed by the Oklahoma Corporation Commission for approximately eight and a half years in various capacities in the Telecommunications Division.

Q. What are your current responsibilities?

A. As the Assistant Director, I review submissions that are filed with the Commission and make policy recommendations to the Director regarding those filings.

Q. What is the purpose and scope of your testimony?

A. The scope of my testimony is to evaluate the impact of the Agreement and Plan Merger ("Agreement") between Verizon Communications, Inc. ("Verizon") and MCI, Inc. ("MCI") upon Verizon's and MCI's Arizona subsidiaries, operations and customers. This testimony examines the Applicants and their subsidiaries, the proposed transaction, the impact upon Arizona consumers, public interest considerations associated with the proposed merger, bonding requirements and compliance issues. Staff Witness Armando Fimbres will evaluate the merger's impact upon competition in the various Arizona markets.

APPLICANTS, THEIR ARIZONA SUBSIDIARIES AND PROPOSED MERGER

Q. Please Describe the Participants to the Proposed Merger.

A. The proposed merger is between Verizon and MCI.

Verizon Communications, Inc. is a Delaware corporation. Its principal office is located in New York, New York. Verizon's telephone operating company subsidiaries provide telecommunications service in 29 states, Puerto Rico, and the District of Columbia, serving approximately 53 million access lines, with approximately 9,300 access lines being served in Arizona. Verizon's domestic telecommunications services include the provision of exchange telecommunications services, including switched local residential and business services, local private line, voice and data services, and Centrex services. It also provides intraLATA and interLATA toll and interexchange services, as well as exchange access services, including switched and special access services. Verizon's other domestic subsidiaries provide voice and data wireless services, information services including directory publishing, and electronic commerce.

Verizon had annual operating revenues of approximately $71 billion in 2004. Verizon has approximately 210,000 employees nationwide, including approximately 1,450 employees in Arizona (wireless and wireline).

Verizon is the corporate parent of the following subsidiaries that provide telecommunications services in Arizona: Verizon California Inc.; Verizon Select Services Inc.; One Point Communications-Colorado, LLC d/b/a Verizon Avenue ("Verizon Avenue"); Bell Atlantic Communications, Inc. d/b/a Verizon Long Distance ("Verizon Long Distance"); and NYNEX Long Distance Company d/b/a Verizon Enterprise Solutions ("Verizon Enterprise Solutions") (collectively the "Verizon subsidiaries"). Verizon California Inc. is the Incumbent Local Exchange Carrier ("ILEC") in parts of western Arizona where it serves the majority of Verizon's access lines in Arizona, or approximately 8,000 lines. One Point is a very small, niche provider in the multi-dwelling unit market in Arizona.

MCI is a Delaware corporation with its principal place of business located in Ashburn, Virginia. MCI's subsidiaries provide services to business and government customers including 75 federal government agencies. Among the enterprise services that MCI provides through its subsidiaries are data, Internet, voice, IP network technology, Virtual Private Networking, SONET private line, frame relay, ATM, and dedicated, dial and value-added Internet services. MCI subsidiaries also provide consumer services, including interstate long distance services, intrastate toll service, competitive local exchange services and other telecommunications services in Arizona.

In 2004, MCI had annual operating revenues of approximately $21 billion. MCI has over 42,500 employees nationally and internationally, including approximately 1,000 Arizona employees.

MCI is the parent corporation of MCImetro Access Transmission Services LLC d/b/a MCImetro ("MCImetro"); MCI WorldCom Network Services, Inc.; TTI National, Inc.; Teleconnect Long Distance Services and Systems Co. d/b/a Telcom*USA ("Telecom*USA"); MCI WorldCom Communications, Inc.; and Intermedia Communications, Inc. (collectively the "MCI subsidiaries"), all of which provide telecommunications services on a statewide basis in Arizona. Intermedia Communications, Inc. has requested cancellation of its Certificate of Convenience and Necessity ("CC&N") as part of MCI's CLEC consolidation. The request to cancel the CC&Ns was filed before the proposed merger in Docket Nos. T-03291A-05-0038; T-03541A-05-0038. MCI's affiliates are among the largest interexchange carriers and competitive local exchange carriers in Arizona.

Q. Please provide a comparision of both Companies Arizona operations.

A. Verizon stated in response to Staff's data request that it received revenue from providing local exchange and long distance services in Arizona during 2004. MCI stated that it had annual revenues from providing local exchange and in-state long distance services in Arizona during the calendar year 2004. MCI received more revenue from its Arizona customers in 2004 than Verizon received from its Arizona customers in 2004. **Exhibit 1** compares the total 2004 annual revenue received by each Verizon subsidiary and each MCI subsidiary in Arizona. Verizon derives most of its revenues by providing local exchange services while MCI derives most of its revenues from the provisions of interexchange services. See Exhibit 2.

The attached **Exhibit 2** is prepared based on the responses to Staff's data request. The number of long distance customers in Arizona is shown for each Verizon subsidiary and each MCI subsidiary. The number of long distance customers being served in Arizona by MCI is greater than the number of long distance customers being served in Arizona by Verizon.

The response to Staff's data request shows that more residential and business customers in Arizona receive local exchange services from MCI than from Verizon. **Exhibit 3** shows the number of Verizon residential and business customers and MCI residential and business customers in Arizona receiving local exchange service.

Exhibit 4 shows the number of local exchange access lines for both residential and business cutomers for Verizon in Arizona. It also shows the number of access lines used to provide local exchange service to MCI residential customers and business customers in Arizona. The response to Staff's data request shows that MCI has more access lines serving its residential customers and business customers in Arizona than the number of access lines serving Verizon residential customer and business customers in Arizona. However, MCI's access lines are mainly lines that belong to an ILEC (Qwest for the most part) that MCI is leasing as an unbundled network element ("UNE"). Whereas, Verizon actually owns the bulk of its access lines.

Q. Please Briefly Describe The Proposed Merger Between Verizon and MCI?

A. MCI will merge into ELI Acquisition, LLC. a Delaware limited liability company, which is wholly owned by Verizon, and created solely to facilitate the merger transaction. ELI Acquisition, LLC will be the surviving company in the merger. Verizon will be the parent company after the merger. The merger will result in combining the businesses of Verizon and MCI. Verizon will rename the surviving company MCI, LLC. MCI, LLC will be a subsidiary of Verizon. MCI's regulated subsidiaries in Arizona will remain as subsidiaries of MCI, LLC.

Under the First Amendment to the Agreement, MCI shareholders receive the right to receive a total of $26.00 (rather than the $23.10 contemplated by the March 29 Amendment) in cash and Verizon stock for each share of MCI stock they tender. The proposed merger will be financed by a combination of equity and cash payment. Under the proposed acquisition of MCI, Verizon will pay a total of $26.00 in the form of cash and Verizon stock for each share of MCI stock shareholders tender. MCI shareholders will receive 0.5743 shares of Verizon common stock for every share of MCI stock. In addition, MCI shareholders will receive a special dividend in the amount of $5.60 per share, less any dividend paid by MCI between February 14, 2005, and the consummation of the transaction.

AFFILIATED INTEREST RULES

Q. Did the Applicants file a Notice of Intent Under Arizona Administrative Code ("A.A.C.") Rules R14-2-803?

A. Yes, the Applicants filed a Notice on April 13, 2005. They subsequently filed two amendments to their Notice.

The first amendment was filed on May 6, 2005. This amendment involved modifying certain financial and other terms of Verizon's proposed acquisition of MCI. The second amendment to the Notice of Intent was filed on July 1, 2005. The second amendment involved previous waivers granted to predecessors of the Companies of the Affiliated Interest Rules, A.A.C. R14-2-801 *et seq*., and the Companies' position that they should not have to obtain Commission approval of the mergers under those waiver decisions.

Q. Does Staff agree with the Applicants' position in the Second Amendment to their Notice of Intent regarding the need for review under the Affiliated Interests Rules? If not, please explain Staff's reason(s) why the Applicants should be required to seek approval of their proposed merger under the Affiliated Interests Rules?

A. No, Staff does not agree with the Applicants' position that they have no obligation to obtain prior Commission approval of the transaction under the Affiliated Interest Rules because of prior waivers granted to certain of their predecessors.

The Companies rely in part upon a limited waiver of R14-2-803 granted to MCI's subsidiaries (MCImetro Access Transmission Services, LLC; MCI WorldCom communications, Inc.; MCI WorldCom Network Services, Inc.; and Teleconnect Long Distance Services and Systems Company) by the Commission in Decision No. 62702 issued on June 30, 2000. That waiver required the MCI subsidiaries to file a Notice of Intent if a reorganization is likely to result in: (i) significant increased capital costs of its Arizona operations; (ii) significant additional costs allocated or charged directly to the Arizona jurisdiction; or (iii) a significant reduction in the net income of its Arizona operations.

They also rely upon Decision No. 58232, wherein the Commission granted Contel of the West, Inc., d/b/a GTE West ("GTE West') and Contel of California, Inc. ("Contel CA") a limited waiver of A.A.C. R14-2-803 of the Affiliated Interest Rules on March 24, 1993. Like the MCI waiver, the waiver granted to GTE West required the Company to file a Notice of Intent if a reorganization is likely to result in (i) significant increased capital costs to the Arizona jurisdiction; (ii) significant additional costs allocated or charged directly to the Arizona jurisdiction; or (iii) a significant reduction in the net income of its Arizona operations.

The Companies also argue that several of their affiliates are not Class A utilities and for this reason do not have to obtain Commission approval. While this is a legal issue, I would offer the following brief comments. First, these limited waivers were granted a long time ago. There was no transfer of the waivers, at least in the case of Verizon. Second, the existence of the limited waivers by itself does not limit or restrict the Commission's ability or authority to review certain transactions when and if it believes that a review is warranted. Third, the Commission must ensure that a transaction of this nature is in the public interest. Where the Commission believes that there is a need for review, the Commission is obligated to undertake a review to ensure that the public interest is being served by the transaction. Verizon Witness Paul B. Vasington at p. 3 of his Direct Testimony acknowledges that "[t]he ACC also may evaluate the transaction pursuant to its constitutional duty to determine whether the transaction is in the public interest, the 'scope and breadth' of which is influenced by the 'individual circumstances of each case.'"

Staff does not find the Companies arguments' regarding the fact that certain of their affiliaties are not Class A utilities to be persuasive. Verizon has a Class A subsidiary, Verizon California Inc., and MCI has three Class A subsidiaries, MCImetro Access Transmission Services LLC d/b/a MCImetro; MCI WorldCom Communications, Inc.; and MCI WorldCom Network Services, Inc. and thus all of these entities would be encompassed by the rule.

Q. Did the Applicants provide information that is required in the Notice of Intent and did Staff review the information to ensure it was complete and met the requirements of A.A.C. Rule R14-2-803?

A. Yes. In their Notice of Intent filed pursuant to A.A.C. R14-2-803, the Applicants provided some but not all of the information required by that section of the Affiliated Interest Rules. Staff reviewed the information provided by the Applicants and has concluded that there are two deficiencies. First, the names and business addresses of officers and directors of the proposed Holding Company have not yet been determined. The names and business addresses of the Verizon and MCI officers and directors should be provided to the Commission when this information becomes available. Second, copies of all relevant documents and filings with the United States Securities and Exchange Commission and other federal or state agencies need to be filed with the Commission as required in A.A.C. R14-2-803.

ARIZONA MERGER EFFECTS

Q. Has Staff evaluated the impact of the proposed merger on the Verizon subsidiaries and MCI subsidiaries in Arizona?

A. Yes. If the merger is approved, only a change in the ownership and control of the MCI subsidiaries will take place. Verizon will become the corporate parent of MCI. Each Verizon subsidiary and MCI subsidiary will continue to operate as the same stand alone entity as they have in the past, according to the Companies.

Q. How many managerial, technical, and customer service employees do Verizon and MCI have in Arizona?

A. Based upon the information provided to Staff, both Companies have management and non-management employees in Arizona. The total number of people employed by Verizon in Arizona is more than the total number of people employed by MCI in Arizona. **Exhibit 5** shows the number of Verizon employees and MCI employees in management and non-management positions in Arizona.

Q. If the proposed merger is approved, how many employees will be kept in Arizona?

A. According to Verizon's responses to Staff's data requests, Verizon and MCI have not engaged in any post-transaction planning and have not identified any employees or positions that will be eliminated as a result of the proposed merger transaction. Verizon and MCI have indicated that they have not identified whether the number of Verizon and MCI employees will increase or decrease in Arizona.

Staff believes that Verizon and MCI should inform the Commission of the date and number of Arizona employees and positions that will be eliminated as a result of the merger related activities.

Q. If the merger between Verizon and MCI is approved by the Commission, what is the impact on the assets in Arizona?

A. Verizon Communications Inc. stated in response to a Staff data request that it had total assets of $165.958 billion and MCI, Inc. had total assets of $17.060 billion at year end 2004. Verizon indicated that less than 13 percent of its total assets are under the Commission's jurisdiction in Arizona. Staff has determined that less than one percent of MCI's subsidiaries' assets listed in **Exhibit 6** are in Arizona. **Exhibit 6** shows the total company value of Verizon's subsidiaries that operate in Arizona at year end 2004. The total company value includes total assets operating in all states. Verizon states that Arizona amounts can not be identified.

Finally, according to the Companies, there will be no direct change in the assets of the Verizon subsidiaries or the MCI subsidiaries as a result of the merger.

Q. If the proposed merger is approved by the Commission, what facilities and/or equipment will be added in Arizona? What facilities will be closed or equipment sold in Arizona?

A. Verizon and MCI have not engaged in any post-transaction planning and, accordingly, have not identified any facilities that may or may not be closed or equipment that may or may not be sold as a result of the merger. However, Verizon Witness Paul Vasington stated at page 6 of his Direct Testimony that Verizon had committed to investing $2 billion in enhancing MCI's network and systems, including MCI's Internet Protocol ("IP") based backbone, which the Companies claim will benefit customers that rely on the service that such networks and systems enable. However, it is not known what portion of this investment will be in Arizona.

Q. Does Staff have more specific information on the $2 billion investment to be made by Verizon, and what portion of the investment will go towards improvement in MCI's network and system facilities.

A. No, based on the information provided by the Company in response to a request by Staff, the $2 billion is intended to cover changes to MCI's IT systems and improvements to MCI's networks. Beyond that, Verizon stated that it has not engaged in post-merger planning and cannot say with specificity where the funds will be spent. Staff has no additional information on the $2 billion investment, including the time-frame of such investment, and in what states the investments are to be focused. Staff believes that such information would be of assistance to the Commission in evaluating the benefits associated with this investment, and that it would be helpful if the Companies witnesses provided whatever further information they may have on the investments impact upon the Arizona market in their rebuttal testimony.

Further, at least 90 days prior to the changes to MCI's network and system facilities, the Company should be required to provide the Commission with the dollar amount of the investment to be made in Arizona.

Q. **In addition to further information on the $2 billion investment to be made by Verizon, is there other information that the Companies should provide to the Commission on the merger's impact on existing and future infrastructure?**

A. Staff believes that Verizon and MCI should inform the Commission of the date and facility or facilities that will be closed as a result of merger related activities.

Q. **If the proposed merger is approved by the Commission, will the transaction be transparent to ratepayers.**

A. According to the Company's Testimony, it will be transparent to ratepayers. Verizon Witness Paul B. Vasington states at p. 8 of his Direct Testimony that "...there is no change contemplated with respect to the terms and conditions of service; service quality; customer service; the quality of facilities; the rate of investment; the companies' corporate affiliate transaction guidelines and policies; and their respective commitments to their customers and to their communities." In addition, in response to an inquiry by Staff, there will be no impact on the rates currently charged customers.

At page 4 of his Direct Testimony, Mr. Vasington also states that "[n]or does the Agreement call for any change in the rates, terms or conditions for the provision of any communications services provided in Arizona." However, he goes on to state at footnote 4 of his Direct Testimony that "[n]or should the ACC be concerned that an increase in rates will result from completion of the transaction." This statement makes Verizon's intentions with respect to customer rate increases less clear. Staff believes that the Company should provide additional clarification of any rate increases that are contemplated at this time as a result of the transaction in its rebuttal testimony.

Q. How will the merger affect other carriers operations in Arizona?

A. Mr. Fimbres addresses the impact of the merger on competitive conditions in the state. With respect to existing wholesale relationships, the Applicants have indicated that there would be no change and that all affiliates of both Verizon and MCI would continue to honor any existing contracts with other wholesale providers.

Q. Will the merger adversely impact competition in the Arizona telecommunications markets?

A. Mr. Fimbres concludes in his testimony that the proposed merger between Verizon and MCI should not adversely impact competition in Arizona. Given that the competitive positions of Verizon and MCI do not overlap in Arizona, the likelihood that the merger of Verizon and MCI will result in reduced competition in Arizona telecommunications markets is very low. In addition, both Verizon's and MCI's witnesses have stated that MCI's affiliates will continue to operate as they did before the merger.

Q. Will the merger have an adverse impact on cost of capital, cost of services or upon the ability of the combined entity to provide safe, reliable and adequate service in the future?

A. Verizon is one of the largest Regional Bell Operating Companies in the United States. In Staff's opinion they have a very strong financial position and are in an excellent position to attract capital. In response to Staff's data request, Verizon stated that the Verizon/MCI merger transaction will not prevent the companies from attracting capital at fair and reasonable terms. An analysis by Verizon shows that the overall impact on the combined company's ability to raise capital should be negligible. MCI indicates that there should not be a significant impact on the availability of capital for MCI's subsidiaries in Arizona. Accordingly to the Notice of Intent, the proposed merger transaction is expected to improve MCI's access to capital. Also, according to the Applicants, the proposed merger transaction should not adversely affect investment in the Arizona subsidiaries and should result in an entity with increased financial strength. They further indicate that the Arizona-regulated subsidiaries of Verizon and MCI will be able to attract capital on terms no less favorable than before the proposed transaction.

Staff concludes, based upon the above discussion, that the merger will not impair the financial status of any Verizon subsidiaries and/or MCI subsidiaries in Arizona relating to their capital structure and the cost of services; prevent any Verizon subsidiaries and/or MCI subsidiaries in Arizona from attracting capital at fair and reasonable terms.

However, when considering the ability of the Verizon subsidiaries and/or MCI subsidiaries to provide safe, reasonable and adequate service in Arizona, Staff believes that one must evaluate Verizon and/or its various subsidiaries' vocal opposition to state consumer protection measures, such as the Commission's proposed slamming and cramming rules and the Commission's proposed CPNI rules. In addition Verizon and its affiliates have been a strong advocate of preemption at the federal level in *inter alia* recent dockets involving IP-Enabled Serivces and Truth-In-Billing. Further, Staff is disconcerted that the CEO of Verizon has made state preemption its No. 1, No. 2 and No.3 priority, and the impact this may have Arizona's ability to protect consumers. This is discussed further in the public interest section below.

MERGER BENEFITS AND PUBLIC INTERESTS

Q. What are some of the benefits associated with this merger?

A. While the MCI appears to have overcome some of its financial issues, it is still not considered by some to be a financially sound company. Verizon's financial resources and strength should benefit MCI investors and enterprise customers.

The merger should result in a financially stronger combined entity with many more resources and capabilities at its disposal. Verizon and MCI have indicated that the merged company will create a far stronger company with the ability to grow and thrive in the intensely competitive telecommunications industry. As a result, the merged company provides a high degree of stability and certainty for employees and their dependents than either company could on a stand alone basis.

Second, the businesses of both providers in Arizona do appear to complement each other. MCI Witness Beach stated:

> In the enterprise market, MCI's and Verizon's networks, services, and areas of expertise are highly complementary and not overlapping. MCI is strong in the enterprise sector; Verizon is not. MCI operates a large Internet backbone network; Verizon does not. MCI has no wireless assets and offers no wireless services to enterprise customers; Verizon operates a large and successful wireless business.

As Mr. Fimbres noted in his testimony, with the complementary nature of the networks, services and areas of expertise of each entity, combining the separate operations of Verizon and MCI would not appear to result in any duplicate operations in Arizona that would require force reductions and the realignment of resources.

Third, as discussed in the testimony filed by Staff Witness Fimbres, there is no evidence in the record that the merger will materially impact the concentration of competition in either the local exchange market or the long distance market in Arizona.

Fourth, MCI Witness Beach testified that the stronger company that emerges will benefit enterprise and government customers. The Companies also believe that their particular combination will benefit customers by enabling the merged entity to operate at lower costs, to develop high-quality innovative services and to deploy these services rapidly.

Mr. Beach testified that the new company will be able to develop and deploy brand new services more rapidly than either company could on its own. MCI Witness Beach also testified that it will be able to provide an integrated suite of services that can better service government customers. While Staff tends to agree that the merger will probably make the combined entity a stronger competitor in the enterprise market than MCI, it would be helpful if the Company in its rebuttal testimony addressed how and to what degree the synergies of this merger will result in lower costs to consumers. In other words, the Company should produce some hard data to back up its statement that the merger will enable the merged entity to operate at "lower costs'.

Based upon its review of the Companies' Application and their responses to Staff data requests, Staff has been unable to identify any benefits to residential customers, as a result of the proposed merger. MCI, is one of the largest CLECs in Arizona, however, Mr. Beach acknowledges at p. 30 of his Direct Testimony that MCI's residential business is already in decline due to a variety of factors. Its most familiar product is "The Neighborhood" offering of local and integrated local/long-distance services. MCI attributes the decline in its consumer business to the following factors:

a) restrictions on marketing resulting from 'Do Not Call' legislation;

b) erosion of long distance minutes resulting from competition from wireless providers, who offer long distance calling 'for free';

c) entry by the Bell Operating Companies into the long distance business;

d) customer preference for all-distance service and the convenience of one bill from one company for all their telecommunications needs;

e) provision of voice services, whether circuit switched or IP based, by cable companies;

f) availability of broadband-based telecommunications services, including VoIP; and

g) regulatory changes that eliminated the availability of UNE-P at total element long run incremental cost ("TELRIC") rates and adversely affected the economies of MCI's provision of integrated services.

Today, according to MCI Witness Beach, MCI no longer competes on a significant scale for new residential customers. MCI no longer spends any money on any broadcast advertisements. Nationally, its spending on direct mail and print advertising has also been substantially reduced. Likewise, its telemarketing efforts have been significantly reduced. Further, MCI Witness Beach also states at page 17 of his Direct Testimony that MCI is likely to have to increase its charges for these services in the future, with the potential for further declines in its business. At page 18 of his Direct Testimony, Mr. Beach characterizes MCI's consumer business to be on a continuing and irreversible decline nationally and in Arizona.

Neither Verizon nor MCI have given any indication of the extent to which the combined entity intends to provide service in the local exchange mass markets (residential and small business) in Arizona, other than the area where Verizon operates as an ILEC; what the timing of such service provision would be; or how such service would be provisioned. Further, the information provided by the entities on the impact on residential consumers is sketchy at best. The Companies provision of additional information on the transaction's impact on residential consumers would be useful to the Commission in determining the overall benefits of the proposed transaction.

Q. Are there other issues that should be considered by the Commission that may impact on any public interest finding?

A. Yes, a concern was raised by Commissioner Spitzer in a June 29, 2005 letter filed in this Docket regarding statements made by Verizon CEO Ivan Seidenberg regarding consumer protection measures taken by state commissions, which Staff believes needs to be considered. In an article that appeared in the April 16, 2005 San Francisco Chronicle, Mr. Seidenberg openly complained about the role of states in protecting consumers in their jurisdictions and urged Congress to rewrite the Telecommunications Act of 1996 to decrease the role of the states. Mr. Seidenberg was also quoted as saying, "The first thing we'd do is pre-empt the states. That's priority No.1, No.2 and No. 3."

Staff recognizes that any Company has a right to express its views regarding any consumer protection measure that a state may decide to adopt. However, Verizon appears to expect that it will be subject to no consumer protection measures, no matter how necessary or appropriate. While Verizon responded to Commissioner Spitzer's letter, the response did not resolve all of Staff's concerns. The extent of the Company's vocal opposition to state regulation, including measures designed by the Commission to protect consumers, coupled with the fact that preemption appears to be the top priority of Verizon, is of concern to the Staff and should be considered by the Commission in determining whether the merger is in the public interest.

At a minimum, the Company should be required to file in this Docket in the future any comments or petitions advocating preemption of state regulation that it files with the FCC or Congress. The Commission can then at least closely monitor the Company's activities in this regard and respond as it deems necessary.

Q. Did you review the comments filed before the FCC on the proposed merger?

A. Yes, I reviewed the initial comments filed with the FCC on the proposed merger. These comments are primarily focused upon the potential anticompetitive impact of the merger within Verizon's in-region footprint.

Q. Overall, what is Staff's conclusion regarding whether the merger is in the public interest?

A. Overall, Staff believes that there are benefits associated with the merger for MCI investors and enterprise customers as set out above, but at this time Staff cannot find any benefit to residential customers. Based on the benefit to MCI's investors and enterprise customers, Staff believes that the merger is in the public interest. However, Staff would like the Company to provide clarity in the areas identified by the Staff, including a more rigorous analysis of the synergies expected from the merger which lead to the

Companies' claims of "reduced costs to consumers", whether and how much of the $2 billion investment to be made by Verizon will be made in Arizona, the overall benefits to mass market local exchange customers, and the impact upon rates in Arizona.

Q. Has Staff made any inquiries as to what other jurisdictions have done with respect to the merger?

A. Yes. Staff made inquires with some of the Qwest regional Oversight Committee ("ROC") states. The Minnesota Public Utilities Commission has approved the merger with conditions. The Idaho and Colorado Commissions determined that they did not have jurisdiction over the merger. The Washington Utilities and Transportation Commission will be holding hearings on the Application beginning November 3, 2005. The Utah Commission has yet to set a schedule.

Following is a summary[1] for States outside of the Qwest region:

Alaska:	Initial comments were due July 15. Further proceedings to be determined.
California:	Public comment hearings Aug. 15-18. Rest of schedule will depend on whether evidentiary hearings are required. Parties disagree on need; motions in favor are due Aug. 26 with opposition motions Aug. 30. If evidentiary hearings are required, they would be Sept. 21-23, with final briefs Oct. 7, final replies Oct. 14 and a Dec. 1 decision date. Without evidentiary hearings, final briefs are Sept. 26, final replies Oct. 3 and a Nov. 18 decision date
Maine:	Original March approval request withdrawn and refiled in May. PUC on July 8 determined that merger requires investigation. Procedural schedule for review not set, but PUC rules require decision by early Nov.
New Jersey:	First briefing cycle concludes Aug. 19. Evidentiary hearings Sept. 20-22. Final briefs Oct. 14 and final replies Oct. 28. Decision due by Dec. 2.

[1] State Telephone Regulation, VOL. 23, No. 14, July 14, 2005

Ohio:	Final company briefs July 18. Final intervener briefs Aug. 25. Final replies Sept. 9. Decision due in fall.
Pennsylvania:	First briefing cycle concludes Aug. 28. Evidentiary hearings Aug. 13-15. Final briefs Oct. 4 and final replies Oct. 18. Public comment hearing planned, date not yet set.
Vermont:	Public comment hearing July 19. Initial briefing cycle concludes July 27. Discovery concludes Aug. 17. Final prehearing motions Sept. 8. Evidentiary hearings Oct. 6-7. Final briefs Oct. 21. Final replies Oct. 28. Decision due by Nov. 28.

PERFORMANCE BOND REQUIREMENTS

Q. Are all of Verizon subsidiaries and MCI subsidiaries involved in the proposed merger certificated to provide telecommunications services in Arizona? What telecommunications services are provided by each Verizon subsidiary and each MCI subsidiary in Arizona?

A. Yes. Verizon California Inc. currently reported that it provides customer-owned pay telephone services and incumbent local exchange services in Arizona. Verizon Select Services Inc. stated that it currently provides resold long distance telecommunications services in Arizona. Verizon Avenue indicated that it provides resold local exchange service and long distance service to customers in Arizona. Verizon Long Distance and Verizon Enterprise Solutions currently reported that they provide resold long distance services to their customers in Arizona.

MCImetro replied that it provides facilities-based local exchange and long distance services. According to MCI WorldCom Network Services, Inc., it provides facilities-based and resold long distance telecommunications services in Arizona. TTI National, Inc. and Telecom*USA currently provide resold long distance services to customers in Arizona. MCI WorldCom Communications, Inc. is a provider of alternative operator services and long distance services in Arizona. Intermedia Communications, Inc. has docketed an Application, Docket Nos. T-03574A-05-0038 and T-03291A-05-0038, to cancel its CC&Ns in Arizona.

Q. Are the Verizon subsidiaries and MCI subsidiaries required to have performance bonds in Arizona? Please identify the condition, purpose, definition and application of the performance bond to telecommunications services providers in Arizona.

A. Yes. If a telecommunications carrier is authorized to provide resold and facilities-based long distance and resold and facilities-based local exchange telecommunications services in Arizona and the carrier's tariff indicates that it collects from its customers an advance, deposit, and/or prepayment, the carrier is required to post a performance bond of $235,000. The amount of the performance bond for multiple services is an aggregate of the minimum bond amount for each type of telecommunications services granted by the Commission. The amount of bond coverage needed for each service is as follows: resold long distance $10,000 for advances, deposits and/or prepayments collected; resold local exchange $25,000; facilities-based long distance $100,000; and facilities-based local exchange $100,000. The performance bond coverage needs to increase in increments equal to 50 percent of the total minimum bond amount when the total amount of the advances, deposits, and prepayments is within 10 percent of the total minimum amount of the performance bond. Advances exclude the monthly payments for local exchange services that are paid a month in advance.

It is appropriate that the Commission review the existing performance bonds of the subsidiaries involved in providing telecommunications services to ensure that the bonding amounts comply with recent decisions of the Commission. All providers of telecommunications services in Arizona need to be treated in a fair and equitable manner with respect to bonding requirements so that a level playing level is created for all telecommunications service providers in this regard. In addition, this will ensure that customers of all telecommunications service providers in Arizona will receive fair and equitable protection of any advances, deposits, and/or prepayments held by their telecommunications service provider.

Q. **Based on current Commission practice and telecommunications services authorized by the Commission, has Staff determined which Verizon subsidiaries and MCI subsidiaries need to procure a performance bond?**

A. Based on a review of prior decisions and the tariffs filed with the Commission, Staff analysis indicates that there are three Verizon subsidiaries and three MCI subsidiaries that need to procure a performance bond. The evidence to support the need for each subsidiary to obtain a performance bond is listed as follows:

Under Decision No. 63546, issued on April 4, 2004, Verizon Select Services Inc. was not required to procure a performance bond. However, it was authorized to provide facilities-based intrastate (local exchange and long distance) and resold intrastate (local exchange and long distance) service in Arizona. To the best of Staff's knowledge, it currently provides resold long distance and its tariff indicates that it has prepaid calling cards for their customers in Arizona, Verizon Select Services Inc. should obtain a performance bond of $235,000. The bond amount should be increased in increments of $117,500. The increase should occur when the total amount of any advances, deposits and prepayments is within $23,500 of the bond amount. The alternative operator services currently being provided by Verizon Select Services Inc. does not require a performance bond.

In Decision No. 62086, OnePoint Communications - Colorado[2] was authorized to provide competitive facilities-based and resale intrastate interLATA and intraLATA telecommunications services and local exchange services. It currently provides resold local exchange and long distance telecommunications services in Arizona. In addition, its filed tariff indicates that it has prepaid calling cards for its customers in Arizona. Consequently, OnePoint Communications - Colorado d/b/a Verizon Avenue should obtain a performance bond in the amount of $235,000 to ensure that a minimum amount of funds are available to protect its consumers in Arizona. The bond amount should be increased in increments of $117,500. The increase should occur when the total amount of any advances, deposits and prepayments is within $23,500 of the bond amount.

One Point was required to maintain an escrow account of $100,000 under Decision No. 62086. Also, Staff recommends that the $100,000 held in escrow be removed as a requirement in Decision No. 62086. Removal of the escrow account will help establish standards to ensure that application of the performance bond is done in a uniform and consistent manner.

In Decision No. 61845, Bell Atlantic Communications[3] was granted a CC&N to provide interLATA/intraLATA resold telecommunications services, with the exception of local exchange services. Bell Atlantic Communications, now known as Verizon Long Distance, stated that it provides resold long distance services and offers a prepaid long distance plan to its customers in Arizona. As a result of providing resold long distance and having a prepaid payment plan, it should obtain a performance bond of $10,000. The bond amount should be increased in increments of $5,000. The increase should occur

[2] One Point is doing business as Verizon Avenue. See Decision No. 64147.
[3] Bell Atlantic Communications subsequently changed its name to Verizon Long Distance. See Decision No. 63351.

when the total amount of any advances, deposits and prepayments is within $1,000 of the bond amount.

In Decision No. 59983, issued on January 16, 1997, MCImetro was authorized to provide intrastate local exchange and intraLATA private line service in Qwest's service territory in Arizona. Also, the company reported that it collects advances, deposits and prepayments from its customers in Arizona. Since the company is able to offer facilities-based and resold local exchange and long distance service and is collecting advances, deposits, and/or prepayments, MCImetro should obtain a performance bond of $235,000. The bond amount should be increased in increments of $117,500. The increase should occur when the total amount of any advances, deposits and prepayments is within $23,500 of the bond amount.

Under Decision No. 61860, issued August 5, 1999, MCI WorldCom Network Services, Inc. was not required to procure a performance bond to provide facilities-based and resold long distance telecommunications services in Arizona. Since the Company's tariff indicates that it has prepaid calling cards, it should procure a performance bond of $110,000 to comply with current guidelines based on past decisions. The bond amount should be increased in increments of $55,000. The increase should occur when the total amount of any advances, deposits and prepayments is within $11,000 of the bond amount.

MCI WorldCom Communications, Inc. reported that it currently maintains an alternative operator services tariff and provides long distances services. Under Decision No. 61860, MCI WorldCom Communications, Inc. was not required to procure a performance bond but was authorized to provide facilities-based and resold local exchange and long distance. See Decision Nos. 59802, 60418, and 61860. In addition, the Company reported that it collects advances, deposits and prepayments from its customers in Arizona. The company should procure a performance bond of $235,000. The bond amount should be increased in increments of $117,500. The increase should occur when the total amount of any advances, deposits and prepayments is within $23,500 of the bond amount.

OUTSTANDING COMPLIANCE ISSUES AND/OR OBLIGATIONS

Q. Has Staff determined whether any of Verizon's subsidiaries or MCI's subsidiaries have any outstanding issues and/or obligations that need to be resolved?

A. Yes. For each Verizon subsidiary and MCI subsidiary in Arizona, Staff reviewed consumer service complaints, corporation issues, compliance items, and accident/outage reports.

Q. Are there any Verizon subsidiaries or MCI subsidiaries that have outstanding consumer service issues that need to be addressed with the Commission?

A. Each of the Verizon subsidiaries stated that they are not aware of any outstanding consumer service issues that need to be addressed with the Commission in Arizona. Each of the MCI subsidiaries in Arizona indicated that there are no outstanding consumer service issues that need to be addressed with the Commission.

Consumer Services reported that from January 1, 2002 to the month ending July 2005, the Commission received 851 complaints, inquiries, and/or opinions from Arizona consumers regarding Verizon and MCI services. Based on the total number of residential and business access lines reported in **Exhibit 4** by each Verizon subsidiary and MCI subsidiary operating in Arizona, the total number of complaints, inquiries, and/or opinions account for 1.8 percent of Verizon's and MCI's total number of access lines in Arizona. This percent ratio of complaints, inquiries, and comments to total number of access lines over a 43 month period lends support to the conclusion that Verizon subsidiaries and MCI subsidiaries have been providing an acceptable level of service.

Q. Are there any Verizon subsidiaries or MCI subsidiaries in Arizona that have outstanding corporation issues that need to be addressed with the Commission?

A. Each Verizon subsidiary claims that they do not have any outstanding corporate issues that need be addressed with the Commission. MCI reports that its subsidiaries in Arizona do not have any corporation issues that need to be resolved with the Commission.

Consumer Services reported that all Verizon subsidiaries are in good standing, except Verizon Enterprise Solutions. There is no record of registration of the d/b/a name Verizon Enterprise Solutions in the Corporation Section of the Commission. Also, Consumer Services indicated that all of MCI's subsidiaries are in good standing, except Telecom*USA. Telecom*USA is not in good standing because it is delinquent in filing its Annual Report due May 29, 2005. In addition, there is no record of registration of the d/b/a name Telecom*USA with the Corporation Section of the Commission. Both Verizon and MCI should be required to register the d/b/a name of their respective subsidiaries with the Corporations Section of the Commission. MCI should also be required to file the delinquent 2004 Annual Report of Telecom*USA with the Commission.

Q. Are there any Verizon subsidiaries or MCI subsidiaries that have outstanding compliance issues that need to be addressed with the Commission?

A. All of the Verizon subsidiaries and MCI subsidiaries in Arizona reported that they are not aware of any outstanding compliance issues that need to be addressed with the Commission.

According to the Compliance Section, several of the Verizon and MCI subsidiaries had outstanding compliance issues at the time the application was filed. However, the Applicants have worked with Staff on these issues and there are currently no outstanding compliance issues with any of the Verizon or MCI subsidiaries.

Q. Has any Verizon subsidiary or MCI subsidiary in Arizona had any or made any accident reports and/or outage reports to the Commission in the last three years? If so, please explain and describe the details of the accident and/or outage reported.

A. Verizon California Inc. stated that it had one outage and made an outage report to the Commission. The outage occurred on March 19, 2005, when a non-Verizon employee/contractor severed two cables with a backhoe. Staff in Consumer Services confirmed that this outage was reported to the Commission by Verizon on March 19, 2005

Verizon Long Distance and Verizon Enterprise Solutions indicated that they resell long distance telecommunications services and do not own facilities that would incur a need to report an outage in Arizona. These Verizon subsidiaries also stated that they do not have employees in Arizona and would not need to make an Accident Report to the Commission.

MCI reported that there was an automobile accident on May 2, 2003. The claim was paid as follows: bodily injury, $8,348.65; property damage, $7,106.47; and expenses, $1,232.50. In response to Staff's inquiry, MCI did not identify the specific subsidiary that the employee involved in the May 2, 2003 automobile accident was working for. MCI stated that this accident was not reported to the Commission. There are no other accidents to report.

MCI failed to file an accident report with the Commission, as required under Commission rules. As a result, MCI and its subsidiary violated A.A.C. R14-2-101 (A). MCI should identify the subsidiary involved and provide a follow-up report to the Commission as required by A.A.C. R14-2-101 (B). Providing specifics in the follow-up report as indicated in A.A.C. R14-2-101 (A), (B), and (C) will ensure compliance with R14-2-101 (C).

STAFF'S RECOMMENDATIONS

Q. Do you recommend that the Commission approve the reorganization proposed by Verizon and MCI?

A. Yes. Staff believes that there are benefits associated with the merger for MCI investors and enterprise customers as set out above, but at this time Staff cannot find any benefit to residential customers. Based on the benefit to MCI's investors and enterprise customers, Staff believes that the merger is in the public interest The Companies should provide further information in the areas identified in my testimony however to assist the Commission in its evaluation of this merger, whether it meets the requirements of R14-2-803, and whether it is in the public interest.

Staff recommends approval of the proposed merger subject to the following conditions:

a. The Companies should provide with their rebuttal testimony the remaining information required under A.A.C. R14-2-803, including the names and business addresses of Verizon and MCI officers and directors and any relevant documents and filings with the SEC and other state and federal agencies.

b. The Commission should, in a separate proceeding, evaluate whether any limited waivers of the Affiliated Interest Rules should be granted to Verizon, and the nature of any such waiver.

c. The Commission should require the Companies to file a notice with the Commission when the merger has been consummated within 30 days of its consummation.

d. The Commission should require Verizon to file in this Docket copies of all petitions and/or comments filed at the FCC or with Congress which seek preemption of state regulation.

e. At least 90 days prior to improvements to MCI's network and system facilities, Verizon shall provide the Commission with the dollar amount of the investment to be made in Arizona.

f. The Commission should require Verizon Select Services Inc., Verizon Avenue, MCImetro, and MCI WorldCom Communications, Inc. to each procure a performance bond of $235,000. The bond amount should be increased in increments of $117,500. The increase should occur when the total amount of any advances, deposits and prepayments is within $23,500 of the bond amount.

g. The Commission should require Verizon Long Distance to obtain a performance bond of $10,000. The bond amount should be increased in increments of $5,000. The increase should occur when the total amount of any advances, deposits and prepayments is within $1,000 of the bond amount.

h. The Commission should require MCI WorldCom Network Services, Inc. to procure a performance bond of $110,000 to comply with current Commission practice. The bond amount should be increased in increments of $55,000. The increase should occur when the total amount of any advances, deposits and prepayments is within $11,000 of the bond amount.

i. Staff in Consumer Services reported that all Verizon subsidiaries are in good standing, except Verizon Enterprise Solutions. There is no registration of a d/b/a name Verizon Enterprise Solutions in the Corporations Section of the Commission. Also, Staff in Consumer Services indicated that all of MCI subsidiaries are in good standing, except Telecom*USA. Telecom*USA is not in good standing because it is delinquent in filing its Annual Report due May 29, 2005. In addition, there is no registration of a d/b/a name Telecom*USA in the Corporations Section of the Commission. The Commission should require both Verizon and MCI to register their respective subsidiaries' d/b/a names with the Corporation Section of the Commission. The Commission should also require MCI to file the Annual Report of Telecom*USA for 2004 with the Commission.

j. MCI should identify the subsidiary involved in the reported car accident and provide a follow-up report to the Commission as required by A.A.C. R14-2-101 (B). Providing specifics in the follow-up report as indicated in A.A.C. R14-2-101 (A), (B), and (C) will ensure compliance with R14-2-101 (C).

k. For a period of one year or the completion of all merger related activities which ever is later, Verizon and MCI should be required to inform the Commission and the Director of Utilities Division of any planned layoffs and/or closing of facilities at least 60 days in advance of any such action as a result of merger related reduction in force activities.

l. At least 90 days prior to changes to MCI's network and system, the company should provide the Commission with the dollar amount of investment to be made in Arizona.

m. Compliance with the additional conditions contained in Mr. Fimbres' testimony.

Staff believes that overall the proposed reorganization is in the public interest, if Staff's conditions are met, and should be approved with the conditions recommended by Staff.

Q. Does this conclude your direct testimony?

A. Yes, it does.

Exhibit 1

2004 Revenue

CONFIDENTIAL

Exhibit 2

LD Customers

CONFIDENTIAL

Exhibit 3

LEC Customers

CONFIDENTIAL

Exhibit 4

Access Lines

CONFIDENTIAL

Exhibit 5

Employees

CONFIDENTIAL

Exhibit 6

Assets

CONFIDENTIAL

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
MARC SPITZER
Commissioner
WILLIAM A. MUNDELL
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION OF VERIZON CALIFORNIA INC., VERIZON SELECT SERVICES INC, ONEPOINT COMMUNICATIONS - COLORADO, L.L.C. DBA VERIZON AVENUE, BELL ATLANTIC COMMUNICATIONS, INC. DBA VERIZON LONG DISTANCE, NYNEX LONG DISTANCE COMPANY DBA VERIZON ENTERPRISE SOLUTIONS, MCIMETRO ACCESS TRANSMISSION SERVICES, L.L.C., MCI WORLDCOM NETWORK SERVICES, INC., TTI NATIONAL, INC., TELECONNECT LONG DISTANCE SERVICES AND SYSTEMS COMPANY DBA TELECOM*USA, MCI WORLDCOM COMMUNICATIONS, INC. AND INTERMEDIA COMMUNICATIONS, INC. FOR APPROVAL OF A REORGANIZATION.	) DOCKET NOS.	T-01846B-05-0279 T-03258A-05-0279 T-03475A-05-0279 T-03289A-05-0279 T-03198A-05-0279 T-03574A-05-0279 T-02431A-05-0279 T-03197A-05-0279 T-02533A-05-0279 T-03394A-05-0279 T-03291A-05-0279

DIRECT

TESTIMONY

OF

ARMANDO FIMBRES

PUBLIC UTILITIES ANALYST IV

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

SEPTEMBER 2, 2005

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This proposed merger will combine the operations and networks of one of the largest Incumbent Local Exchange Carriers (ILECs), interexchange carriers and wireless providers in the United States, Verizon Communications, Inc. ("Verizon"), with one of the largest Competitive Local Exchange Carriers ("CLECs") and interexchange carriers in the United States, MCI, Inc. ("MCI").

Unlike states where Verizon is the dominant or a major incumbent local exchange carrier, with considerable overlap between Verizon's and MCI's operations, there is almost no overlap in Verizon's and MCI's Arizona operations. Consequently, combining the separate operations of Verizon and MCI would not appear to result in any duplicate operations in Arizona that would require force reductions and the realignment of resources.

Verizon's local exchange presence in Arizona is largely limited to a small ILEC area on Arizona's western border; while MCI offers CLEC service to a number of Arizona customers largely within Qwest's service territory. However, MCI has already decided to curtail its mass market CLEC operations in Arizona.

Verizon does not have a strong presence in the Arizona enterprise market. MCI, however, has a very strong presence in the Arizona enterprise market. Verizon clearly benefits by its ability to enter this market in Arizona through an established provider such as MCI. Both carriers are optimistic that the merger will strengthen their presence in this market. Given the commitment of both entities to the enterprise market, Staff believes the merger will likely benefit competition in the enterprise market.

Verizon also is certificated to provide interexchange service through an affiliate in Arizona, but it has no significant presence in Arizona. MCI has a very significant presence in the Arizona long distance market, and continues to be one of the predominant interexchange providers in the state. MCI will continue to offer interexchange service to customers in Arizona as a subsidiary of Verizon after the merger.

Since the operations of Verizon and MCI are complementary at this time in Arizona, there are likely to be no anticompetitive impacts in the Arizona local exchange or interexchange markets. One concern at this time is the small area served by Verizon as an ILEC along Arizona's western border. While MCImetro is certificated to provide CLEC service, customers are not yet being served in Verizon's ILEC area. Staff is recommending that MCImetro be required to obtain the Commission's approval before providing service as a CLEC in Verizon's ILEC territory.

Staff recommends approval of the Verizon/MCI merger application.

INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Armando Fimbres. I am a Public Utilities Analyst IV employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Briefly describe your responsibilities as a Public Utilities Analyst IV.

A. In my capacity as a Public Utilities Analyst IV, I provide information and analysis to Staff on telecommunications tariff filings, emerging industry issues, such as VoIP, and matters pertaining to major applications, such as the merger application filed by Verizon and MCI.

Q. Please describe your educational background and professional experience.

A. I received a Bachelor of Science degree from the University of Arizona in 1972 and have taken business and management courses at Seattle University, Northwestern University and the University of Southern California. I was employed for nearly twenty-nine years in Bell System or Bell System-derived companies, such as Western Electric, Pacific Northwest Bell, U S WEST and Qwest. The last twenty years of my Bell System telecommunications experience were in operations planning, corporate planning, or strategic planning roles with a special emphasis from 1994 to 2000 on competitive and strategic analysis for the Consumer Services Marketing division of U S WEST and similarly from 2000 to 2001 for Qwest. I have been with the Arizona Corporation Commission Utilities Division since April 2004.

Q. What is the scope of your testimony in this case?

A. I will address the competitive environment in which the Verizon/MCI application is being evaluated. My testimony will primarily focus on the merger's impact upon the Arizona intrastate long distance and local exchange markets.

BACKGROUND

Q. What is the purpose of your testimony?

A. In addition to providing information on the general competitive environment in which the Verizon/MCI application is being evaluated, I will provide specifics regarding Verizon's and MCI's position within Arizona telecommunications markets and try to assess the impacts the merger is likely to have on Arizona consumers.

Q. Explain the primary information sources used in your analysis.

A. I have relied on information obtained in other proceedings such as the Qwest Filing of Renewed Price Regulation Plan, Docket No. T-01051B-03-0454, and the Federal Triennial Review ("TRO"), Docket No. T-00000A-03-0369, as well as information provided by the Applicants in this proceeding. I have also made use of Annual Report information filed by all telecommunication providers with the Commission.

GENERAL COMPETITIVE ENVIRONMENT

Q. What is the general competitive environment pertaining to the Verizon/MCI application?

A. Given the growth characteristics of the Arizona market, Staff believes that while competition has increased, the general state of local exchange competition is not where it should be nine years since the Federal Telecommunications Act of 1996 was enacted. The competitive environment in which this application is being evaluated is being impacted by a number of factors within and outside the local exchange market. Many of the general competitive factors might be viewed as relevant to the merger agreement.

Q. Can you describe some of the key factors in the general competitive environment?

A. The Verizon/MCI merger application is being evaluated in an environment that Staff summarizes as follows:

1. A very important general factor in Arizona's competitive environment is market size. Arizona is second only in size to Washington State within Qwest's incumbent local exchange carrier ("ILEC") region. Arizona's position near or at the top in growth nationally should be a magnet for local exchange competition and deployment of many telecommunications alternatives and technologies.
2. Nonetheless, Staff believes that local exchange competition in its traditional sense has slowed and some may argue that the size of the local exchange market is actually in decline. At the time of the 1984 AT&T Divestiture, the penetration of main lines in homes was believed to be very high, approaching a main line in every home, and the wireline provider focus turned to providing additional lines. Competitive alternatives have since impacted both main and additional line markets. Even more significant has been the impact on the long distance market.
3. Wireline competition, associated with local exchange service and enabled by the 1996 Telecommunications Act, has slowed, in part because of changes in the Federal Communications Commission's ("FCC") Unbundled Network Element ("UNE") rules and in part because of the continuing evolution of technology in areas of customer demand that are difficult to satisfy with traditional wireline service.
4. Wireless competition has experienced enormous growth over the last few years. In Arizona, the number of wireless phones is approaching the number of wireline

phones[2]. Wireless and internet email are believed to have been significant factors in the downward movement of long distance rates.

5. Voice over Internet Protocol ("VoIP"), Wireless Fidelity ("WiFi") and Worldwide Interoperability of Microwave Access ("WiMAX") are perhaps the most current examples of technologies that are impacting the local exchange and long distance markets. More recently, Interactive Protocol-based TV ("IPTV") has gained considerable attention. All are technologies that may not yet have much direct impact on local exchange wireline voice services but, nonetheless, compete for the discretionary end-user dollars available for local exchange and long distance services.

6. Some weight must also be given to the concern being raised in Congress[3] and perhaps more generally regarding the consolidation and reorganization that appears to be taking place in the telecommunications industry. Cox Communications has been taken private; Cingular has acquired AT&T Wireless; Sprint and Nextel have merged; and two major merger applications are in process – SBC/AT&T and Verizon/MCI. Whether these changes result in healthier and more robust competitors that ultimately advantage competitive markets remains to be seen. What does seem likely is that several significant brands and, thereby, associated options will be removed from the options once available to customers. Customers who may not appreciate being transitioned from one provider to another through rules governing mergers and acquisitions may find that their traditional choices are suddenly more limited.

[2] 12/22/04, "Federal Communications Commission Releases Data On Local Telephone Competition", Table 9, Table 13

[3] March 2, 2005, IDG News Service, "U.S. lawmakers question telecom mergers"

Q. How many competitive local exchange carriers ("CLECs") appear to be competing in Arizona's local exchange market?

A. My analysis indicates that as of June 2004, 42 CLECs were providing switched access lines to end-users. The range of participation, however, appears to be quite broad. For example, the top 10 CLECs hold business main listings that equal 92.4 percent of all CLEC business main listings. The top 10 CLECs hold residence main listings that approximately equal 99.4 percent of all CLEC residence main listings. Only 5 CLECs appear in both top 10 lists – AT&T, Arizona DialTone, Cox, MCI, and McLeodUSA. Verizon is not in either top 10 list in Arizona.

Q. How many providers appear to be providing long distance services in Arizona?

A. Validating the number of long distance providers or Interexchange Providers ("IXCs") is more difficult than validating the number of CLECs, however, there are 33 IXCs and 286 Long Distance Resellers listed on the Commission's website[4].

MCI'S COMPETITIVE SITUATION

Q. What is MCI's general competitive situation?

A. MCI's competitive situation has undergone considerable change since its legal challenges precipitated the divestiture of AT&T in 1984. The antitrust lawsuit that it filed against AT&T was the driving force behind the AT&T divestiture and can be credited for reshaping telecommunications in the United States.

By the mid-1990s, MCI appeared to be well on its way to becoming a powerhouse telecommunications provider capable of matching AT&T in long distance and local exchange services. Since that time, however, MCI has undergone many changes leading

[4] http://www.cc.state.az.us/utility/utility_list/IXC_list.pdf

to its current acquisition by Verizon. In 2002, MCI WorldCom reached a pivotal point in its history by filing for chapter 11 bankruptcy, emerging in 2004 under its original name of MCI.

With the general revenue decline in the long distance market, MCI is clearly no longer in the strong competitive position it had reached in the mid-1990s, however, Staff believes that MCI continues to be a major competitor in the Enterprise Market. In Mass Markets, nonetheless, MCI has chosen a similar path pursued by AT&T – to discontinue[5] marketing to local exchange residence customers.

Q. What is MCI's competitive situation specific to Arizona?

A. The available Listings and Local Exchange Routing Guide ("LERG") information[6] indicates that MCI[7] is one of the top CLECs in Arizona. Based on this information, MCI would have to be considered one of the top CLECs providing local exchange service to the business market. In the residence market, MCI is noteworthy but well below several competitors.

Q. Is MCI currently providing CLEC services in any Verizon ILEC areas?

A. MCI Witness Beach stated that MCI is not currently providing any CLEC services in Verizon's ILEC service area. MCI's response to Staff data requests also stated that MCI has not requested interconnection agreements with Verizon California.

[5] The Washington Times, August 6, 2004, "MCI set to downsize residential service"
[6] June 2004
[7] MCI only provides local exchange service in Arizona through MCImetro

Q. Can MCI's local exchange market share in Arizona be estimated?

A. Using Annual Report information[8], I developed an estimate of MCI's 2003 revenue market share in Exhibit 1. The MCI information includes revenue from Arizona affiliates but is dominated by its long distance provider. MCI clearly has a major revenue presence in Arizona. It's reasonable to assume, however, that MCI's residence access line and corresponding revenue position has declined through normal churn since MCI is no longer marketing to the residence market.

MCI's access line market share can also be gauged using the 2003 annual report information. Exhibit 2 suggests that MCI has significant and measurable access line share, however, information provided by MCI in response to Staff fifth set of data requests indicates that MCI's access lines have declined by approximately REDACTED.

Q: Do you have any comments about the MCI facilities in Arizona?

A: MCI Witness Beach mentions that MCI has 2 end-offices in Arizona[9]. That agrees with my LERG analysis. My analysis also indicates, however, that MCI's ratio of NPA NXXs to end-offices is extremely high in Arizona. In general, any end-office with 10 highly utilized NPA NXXs is a heavily loaded and highly utilized end-office. This means that a ratio near or higher than 10:1 deserves some clarification. The number of local exchange access lines served by MCI[10] in Arizona suggests that the number resources assigned to MCI in Arizona far exceed their current needs. This suggests an extraordinary number of highly under utilized NPA NXXs. In the last few years, Arizona has gone from two NPAs to five NPAs in order to address the growing need for more numbers by the PSTN (public telephone switched network). Staff believes that PSTN numbers are too scarce to leave so

[8] MCI provided updated annual report information in response to Staff's fifth set of data requests
[9] Page 7, Direct Testimony of Michael Beach
[10] 2004 MCImetro annual report

highly under utilized. Therefore, MCI should be required to review its numbering resources in the 480, 602 and 623 NPAs.

Q. Please summarize your conclusions about MCI's competitive situation in Arizona.

A. (1) MCI is a significant CLEC providing service to business customers in Arizona.

(2) MCI is a noteworthy CLEC providing service to residence customers in Arizona.

(3) MCI's CLEC position serving residence customers is likely not growing given its announcement to discontinue marketing to residence customers in Arizona and other states.

(4) MCI's CLEC local exchange services have been very dependent on UNE-P services.

(5) MCI's strong position in long distance service has diminished due in part to wireless and internet alternatives, however, its revenue position in Arizona suggests that MCI remains a major force in long distance.

VERIZON'S COMPETITIVE SITUATION

Q. What is Verizon's general competitive situation?

A. Verizon has largely evolved from the Nynex and Bell Atlantic[11] RBOCs, divested from AT&T in 1984, into a holding company that also includes major operations in wireless and long distance. Verizon serves over 50 million wireline access lines in 29 states[12]. The long distance operations of Verizon serve over 17 million lines nationally. Verizon Wireless serves over 47 million customers nationally. With over $71 Billion in total revenues, Verizon can reasonably be considered to have all the essential resources and customer base to compete in any segment of the expanding communications industry.

Q. What is Verizon's competitive situation specific to Arizona?

[11] GTE was acquired by Bell Atlantic in 1998
[12] http://investor.verizon.com/business/wireline.aspx

A. Verizon has five regulated entities in Arizona, only two of which provide local exchange services – Verizon California Inc. and One Point Communications[13]. The total lines served are 99 percent within the Verizon California ILEC area. One Point Communications is a very small, niche provider in the multi-dwelling market. Had Bell Atlantic not acquired GTE on Arizona's western border, Verizon's competitive presence today might be limited to long distance and wireless.

Q. Can Verizon's local exchange market share in Arizona be estimated?

A. Studying Exhibits 1 and 2 confirms that Verizon's presence in the statewide local exchange market in Arizona is not significant. Verizon is the dominant local exchange provider in one small rural market in Arizona. It serves approximately 8,000 access lines in that market. The extent of competition it is facing in its ILEC service territory is unknown at this time. For the purposes of estimating local exchange market share, Verizon's position is effectively zero percent.

Q. Is Verizon currently providing CLEC services outside of its ILEC service area in Arizona?

A. Not to any significant degree. To the best of Staff's knowledge, Verizon's affiliate, One Point, provides service to one multi-dwelling unit outside Verizon's Arizona ILEC service territory.

[13] dba Verizon Avenue

Q. Do Verizon's telecommunications operations have any areas of competitive overlap with MCI operations?

A. There is virtually no overlap between the operations of the Applicants. While Verizon's ILEC operations do not overlap with MCI CLEC operations, there is some minimal overlap between the Verizon CLEC affiliates and MCI CLEC affiliates. However, because the Verizon CLEC operations are so small Staff considers the overlap insignificant. In long distance there is some overlap, however Verizon's long distance operations in Arizona also appear to be extremely limited at best.

Q. Can you please comment on the diversity of Verizon's operations and what impact this may have on consumers in Arizona?

A. Verizon has such diverse and extensive operations that Staff can reasonably state Verizon has interests in every area that directly or indirectly impacts telecommunications. The same can be said about most RBOCs and even the major cable providers. The differences are in degrees of emphasis.

Verizon holds the majority interest in Verizon Wireless which is the 2nd largest national wireless provider behind Cingular (50 million versus 45.5 million[14] subscribers). Verizon has also developed into the 4th largest long distance provider in the US[15], within 3 percent market share of Sprint.

Verizon also has interests in VoIP, IPTV, Fiber-to-the Premises, Broadband, Information Services, Publishing Services, Wi-Fi, Wi-Max, and Hi-Tech end-user devices to help enable the full spectrum of communications services. To the extent that Verizon develops

[14] http://www.verizonwireless.com/b2c/aboutUs/index.jsp?cm_re=HP%20-%20About%20Us; http://www.cingular.com/about/company_overview
[15] FCC, Trends in Telephone Service, June 2005,Table 9.6

a presence in these areas in Arizona, additional competitive alternatives will be available to consumers, and consumers are likely to benefit. However, in response to Staff data requests, Verizon stated that it has done little post transaction strategic planning at this time, so the extent of Verizon's participation in any of these markets is unknown.

Q. Please summarize your conclusions about Verizon's competitive situation in Arizona?

A. (1) Verizon's presence in the Arizona local exchange market as a CLEC providing service to business customers is insignificant.

(2) Verizon's presence in the Arizona local exchange market as a CLEC providing service to residence customers is insignificant.

(3) Verizon earns <u>relatively few</u> revenues with its Arizona operations.

(4) Verizon's Arizona operations do not have significant overlaps with MCI.

(5) Verizon has strong interests in many aspects of communications.

SUMMARY AND CONCLUSIONS

Q. If the merger between Verizon and MCI is approved by the Commission, what could be the impact on Arizona telecommunications markets?

A. Any traditional analysis of the merger's impact on market structure will indicate that Verizon's and MCI's competitive positions in Arizona do not overlap nor appear to conflict. Therefore, the likelihood that the merger of Verizon and MCI will result in reduced competition in Arizona telecommunications markets is very low. Further, both Verizon's and MCI's witnesses have stated that MCI's affiliates will continue to operate as they did before the merger.

The combined forces of Verizon and MCI are likely to initially produce a more formidable competitor in the Enterprise Market in Arizona. Indeed, the Companies have indicated a strong desire to focus on this market.

While Verizon's strength as a local exchange provider in many top markets in the United States would be a welcomed, competitive alternative, neither Verizon nor MCI have made any commitments about increasing their presence in the Arizona local exchange residence market. Therefore, despite the Companies' assertions that benefits will accrue to residence customers in Arizona, the benefits to the mass market cannot be easily quantified at this time.

With respect to the Arizona long distance market, Staff does not believe that the merger will produce any adverse impacts upon the long distance markets in Arizona. The benefits on competition in this market are difficult to quantify at this time.

Q. Will the merger of Verizon and MCI significantly change the market share situation?

A. Staff does not believe any measurable, negative market share impacts will occur due to this merger.

Q. Is there a way to actually measure the combined market impact of the Verizon and MCI merger?

A. Staff used the Herfindahl-Hirschman Index ("HHI") to gauge the level of market concentration. The HHI measures both the number of firms and their degree of inequality. The HHI is the sum of the squares of each firm's market share. This is given by the formula:

$$HHI = \sum_{i=1}^{N} S_i^2$$

Where S_i is the market share of the ith firm and N is the total number of firms.[16] When this formula is applied to the market shares of the CLECs in Exhibits 2 and 3, HHIs based on Arizona Operating Revenue and Total Access Lines can be derived.

A summary point is that the access line and revenue market shares of Verizon are so low that they have no contribution to an HHI calculation. Very simply, Zero squared is Zero.

Q. Are there general factors that were considered in addition to calculation of an HHI?

A. Staff considered key factors used by the Department of Justice ("DOJ") in merger analysis, such as: 1) The Potential Adverse Competitive Effects of Mergers, 2) Entry Analysis, 3) Efficiencies, and 4) Failure and Exiting Assets. These factors are set forth in sections 2-5 of the DOJ's Horizontal Merger Guidelines[17].

1) The Potential Adverse Competitive Effects of Mergers include the merger's effect on the likelihood of collusion among the relevant firms and the merger's effect on the merged firm's ability to unilaterally exert market power. This merger is unlikely to enhance Verizon/MCI's ability to unilaterally exert market power in the long distance market. This is because the merged firm would still be competing with many other long distance providers in addition to major alternatives, such as wireless and internet communications.

[16] For example, a market consisting of four firms with market shares of 30 percent, 30 percent, 20 percent and 20 percent has an HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of a perfectly competitive market). Although it is desirable to include all firms in the calculation, lack of information about small firms is not critical because such firms do not affect the HHI significantly.

[17] http://www.usdoj.gov/atr/public/guidelines/hmg.htm#50

Much the same is true for the local exchange market. Merging MCI, a CLEC with announced intentions to reduce its competition in the local exchange market, with Verizon will not dramatically alter the competitive dynamics of either the long distance or local exchange market.

2) Entry Analysis refers to a determination of the ease of entry by new competitive firms into the relevant market. Given the huge capital investments needed to compete as an IXC or as a facilities-based CLEC, entry into either the long distance or local exchange market is quite difficult. This merger appears to have no effect on the ability of other firms to enter the telecom market.

3) By efficiencies, the DOJ is referring to the idea that the merged firm may be able to realize cost-lowering efficiencies that will enhance its ability to compete. As with most mergers, Verizon and MCI claim that such efficiencies exist. Verizon and MCI have not provided the data that would allow Staff to properly evaluate these claims. However, these claims are plausible. If we assume that there are economies of scale in this industry, then a merged Verizon/MCI would be in a better position to compete than the current smaller entities. If we accept that increases in scale lead to increases in efficiency (and thus lower costs), this merger would make the combined Verizon/MCI a more efficient firm. This would put the merged firm in a better position from which to compete with Qwest, Cox, Sprint, SBC, AT&T and other providers not only in local exchange but in long distance, wireless, broadband and developing markets, such as VoIP, WiFi, WiMAX and IPTV.

4) The DOJ's Failure and Exiting Assets criteria are not fully relevant in this merger since neither company is failing. The financial health of Verizon minimizes any problems that arise from the problems that have confronted MCI since its 1984 divestiture.

Q. What is Staff's conclusion regarding these key factors?

A. Staff can summarize its position in the following table.

Criteria	**VERIZON/MCI merger**
Adverse Competitive Effects	Positive or Neutral
Entry Analysis	Neutral
Efficiencies	Positive or Neutral
Failure and Exiting Assets	NA

Staff believes the Verizon/MCI merger's effect on the state of competition in Arizona's local and long distance markets is unlikely to have a negative impact on Arizona's consumers. The merger should not substantially change the level of concentration in either market.

Q. In light of the historic reluctance by the RBOCs to compete with each other, please explain why the Commission should not be gravely concerned with the prospect of an RBOC purchasing one of the most active CLEC and IXC competitors in Arizona.

A. Staff believes that any negative consequences that may flow from the Verizon and MCI merger should not be of grave concern. Since many mergers are based on force reductions and resource allocations, a shift in MCI's strategy or at least its realignment is certainly possible. However, most force reductions and resource allocations are typically driven by the overlapping areas of merging units. Verizon and MCI have almost no overlap in their

Arizona operations. The local exchange market and long distance operations of MCI are likely not going to be curtailed any more than they have been already by MCI itself prior to the merger announcement, since the Companies have committed that the MCI affiliates will continue to operate as they did before the merger.

Q. What do you see as the resulting company from the Verizon and MCI merger?

A. While it is impossible to be precise about the company that results from this reorganization, two simple observations can be made.

1 – Verizon intends to invest \$2B in MCI's network[18]. No mention is made of MCI investing in Verizon.

2 – Verizon and MCI speak publicly about this organization being a merger. This reorganization is really an acquisition of MCI by Verizon.

While this transaction is being termed a "merger" by many, Mr. Vasingtion, on behalf of Verizon, while using the term merger throughout his testimony, at two points[19] in this testimony very clearly states that Verizon is acquiring MCI. This is a <u>not so subtle</u> distinction that should be appreciated.

Q. Why is the distinction between a merger and an acquisition important?

A. This is important because in some instances much more can be surmised about the competitive moves of the resulting company in the case of an acquisition than in a merger.

[18]Direct testimony of Paul B. Vasington, page 6, lines 14 – 17 and page 39, lines 14 - 19
[19]Direct testimony of Paul B. Vasington, page 34, line 7, and page 40, lines 13 - 15

When two companies are joined, variations of three basic results can occur. (1) Company A and Company B in a true merger will result in Company C, a company this does not mirror either A or B. In a perfect merger Company C would be 50 percent of A and 50 percent of B. (2) In a typical acquisition, however, the resulting company will look more like the company doing the acquiring or, (3) in some acquisitions, the resulting company will look more like the company being acquired. Result (3) occurs when the company being acquired has a much stronger brand, market presence or core competencies than the acquiring company.

The formation of Verizon in the year 2000 that resulted from the merger of Nynex and Bell Atlantic is a good example of (1). There is much to say that the merger of Nynex and Bell Atlantic was a merger of equals and the resulting company brand was different than either of the main parties.

The acquisition of MCI by LDDS, which led to the formation of MCI WordCom, is a reasonable example of (3). Although usually done by intent, condition (3) can also occur by accident when a smaller company acquires a larger company and simply cannot resist the inexorable market, business and employee environment of the larger company.

Verizon is neither small nor does its history suggest a willingness to be a secondary participant, in part exemplified by its determined and yet strategic acquisition competition versus Qwest for MCI. This reorganization clearly meets the general conditions for (2). While MCI has a strong brand and significant presence in the Enterprise Market, the resulting company is going to be more like Verizon than MCI. Clearly, MCI is a valued entity, as can be observed by the acquisition price, but Verizon is going to be in charge of the strategic and operating direction of the resulting company.

Q. Is the resulting company (2) more beneficial to Arizona than if the resulting company were more like (1) or (3)?

A. I believe it is. A resulting company that looked more like (1) or (3) would naturally place more emphasis on the business direction charted by MCI – a reduction in mass market local exchange presence. Verizon's history and core strengths, however, are in local exchange service. This may ultimately portend favorably for Arizona consumers; however any benefits in this regard are speculative and will likely not be seen, if at all, for sometime, given the Companies stated focus at this time.

Q. Does Staff have any reason to believe the company that results from the Verizon/MCI merger will be an aggressive competitor?

A. While Staff is generally optimistic given Verizon's performance as an aggressive, national competitor, the history of Verizon's competitive relationship with Qwest suggests that, of all the RBOCs, Verizon is the one most inclined to compete aggressively in Arizona. Examples of Qwest (formerly U S WEST), the dominant ILEC in Arizona, and Verizon (formerly Bell Atlantic and Nynex) having competing interests can be seen as far back as 1991 when U S WEST announced[20] a video-on-demand trial that included TCI (eventually acquired by AT&T and now part of Comcast), headquartered in Denver, CO. One of the largest TCI video systems was located in Pittsburgh (within the Verizon RBOC region) at the time.

In 1993, Bell Atlantic announced[21] it would acquire TCI which served approximately 9.7 million video subscribers with several large cable systems located in U S WEST's RBOC region. The acquisition effort by Bell Atlantic followed U S WEST's $2.5 Billion

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[20] http://www.cablecenter.org/history/timeline/decade.cfm?start=1990
[21] http://www.cablecenter.org/history/timeline/decade.cfm?start=1990

investment[22] in Time Warner Entertainment in 1993. Time Warner owned and operated large video systems in Verizon's RBOC region. The TCI acquisition effort by Verizon was not successful.

U S WEST followed by acquiring Continental Cablevision[23], with major video systems on the east coast (within Verizon's RBOC region), in 1996. Eventually, the MediaOne Group, the cable organization divested by U S WEST, and TCI were acquired by AT&T and are now owned by Comcast. Most recently, of course, Qwest participated in an aggressive competition with Verizon for the rights to acquire MCI.

The sum of the competing interests that can be traced back nearly 15 years suggests to Staff that Verizon and Qwest continue to have overlapping strategic interests that will hopefully exhibit themselves in Arizona, one of the highest growth areas within Qwest's RBOC region and surely near the top of Qwest's local exchange interests. The strategic competition between Qwest and Verizon at times appears to be so strong, so obvious that the actions by Qwest to wrest MCI from Verizon could be gauged as defensive rather than offensive moves.

Q. Does Staff have any additional observations related to this merger.

A. Yes. Most in the telecommunications industry would agree that the importance of packages and bundles has risen. If so, a geographic portrayal of Verizon's wireline and wireless operations draws attention to an important strategic point (Exhibit 5). While Verizon claims to have a telecom presence in 67 of the top 100 markets nationally, Verizon has a huge gap in wireline geographic coverage that happens to coincide with Qwest's ILEC areas. Verizon has major wireline presence in SBC ILEC areas but very

[22] Megamedia Shakeout by Kevin Maney, April 3, 1995
[23] http://66.179.185.30/history/timeline/decade.cfm?start=1995

little in BellSouth as well as Qwest. With MCI's strong presence in the Enterprise Markets, it's possible to surmise that Verizon would be gaining immediate competitive access to cities, within Qwest's ILEC areas, known for housing many company headquarters and large divisions – Seattle, Denver, Minneapolis, and Omaha. Phoenix's rapid growth, and that of Salt Lake City, would appear to help the competitive portfolio probably desired by Verizon. By closing this gap, Verizon immediately improves its ability to provide packages and bundles in many of the Top 100 markets not currently served with wireline products.

Q. Does Staff have any additional observations related to this merger.

A. Its also worth noting that BellSouth acquired a 10 percent stake in Qwest in May, 1999, previous to Qwest's acquisition of U S WEST.

Q. Please summarize your conclusions about the impact of Verizon's merger with MCI in Arizona.

A. (1) Verizon and MCI have very different competitive positions in Arizona.

(2) Combining the separate operations of Verizon and MCI would not appear to result in duplicate operations in Arizona that would require force reductions and the realignment of resources.

(3) MCI has a significant and measurable share of Arizona's telecommunications market while Verizon's presence in Arizona is very small and limited in scope.

(4) The Verizon and MCI merger may allow Verizon's interests and financial resources to combine with MCI's market presence and thereby accelerate the delivery of service alternatives to Arizona end-users, however, there is no such guarantee.

(5) MCI has already decided to curtail its local exchange operations in Arizona. The impact of the merger on the mass market remains to be seen.

(6) Of importance are the strategic reasons that may be behind Verizon's acquisition of MCI.

(7) Verizon and Qwest appear to have a long history of competition and similar strategic interests.

Q. Do you recommend approval of the Verizon/MCI merger?

A. Yes. Overall, for the reasons discussed in my testimony and those given by Mr. Abinah in his testimony, Staff believes that the merger is in the public interest. From a competitive standpoint, the merger is not likely to have an adverse impact upon competition in any market in Arizona. The Verizon and MCI merger may also allow Verizon's interests and financial resourses to combine with MCI's market presence and thereby accelerate the delivery of service alternatives to Arizona end-users, however, there is no guarantee that this benefit will be seen immediately outside of the enterprise market and the mobile IP markets, given the Companies' stated intentions at this time.

Q. Do you have any conditions on which the Commission should base its approval of the Verizon/MCI merger?

A. Yes.

(1) Verizon/MCI affiliate CLECs should only be allowed to provide local exchange services in Verizon California's ILEC areas under the following conditions:

a) Verizon/MCI CLEC affiliate services can be provided to Enterprise Market[24] customers upon application to and acceptance by the Commission.

b) Verizon/MCI CLEC affiliates must file interconnection agreements with the Commission before providing CLEC services to the Enterprise Market customers.

[24] The Enterprise Market is defined as business customers with 4 or more local exchange access lines.

c) Verizon/MCI CLEC affiliate services cannot be provided to Mass Market[25] Customers without the filing of data which will allow Staff to assess any adverse impact upon Verizon's ILEC's operations.

d) Verizon/MCI affiliate CLECs can only utilize Verizon California CPNI information services to the same degree that non-affiliate CLECs are allowed to utilize Verizon California CPNI information services.

(2) Verizon/MCI long distance affiliates only be allowed to provide long distance services in Verizon California's ILEC areas under the following conditions:

a) Verizon/MCI long distance affiliates must operate under the same long distance customer selection rules that apply to all other long distance providers.

b) Verizon/MCI long distance affiliates can only utilize Verizon California CPNI information services to the same degree that non-affiliate long distance providers are allowed to utilize Verizon California CPNI information services.

(3) MCI shall be required to review its numbering resources in the 480, 602 and 623 NPAs. To the extent that the Company's numbering resources in these NPAs exceed a six month inventory, MCI shall, within sixty days of a Commission Decision in this matter, return to the Pooling Administrator all surplus thousands-blocks with less than ten percent contamination.

Q. Does this conclude your direct testimony?

A. Yes, it does.

[25] The Mass Market is defined as all residence customers and business customers with 3 or less local exchange access lines.

EXHIBITS

1 2003 Total Revenue From Arizona Operations Without Verizon Wireless

2 2003 Total Arizona Residence and Business Access Lines Without Verizon Wireless

3 Verizon's National Geographic Coverage

Exhibit 1

2003 Total Revenue From Arizona Operations
Without Verizon Wireless

REDACTED

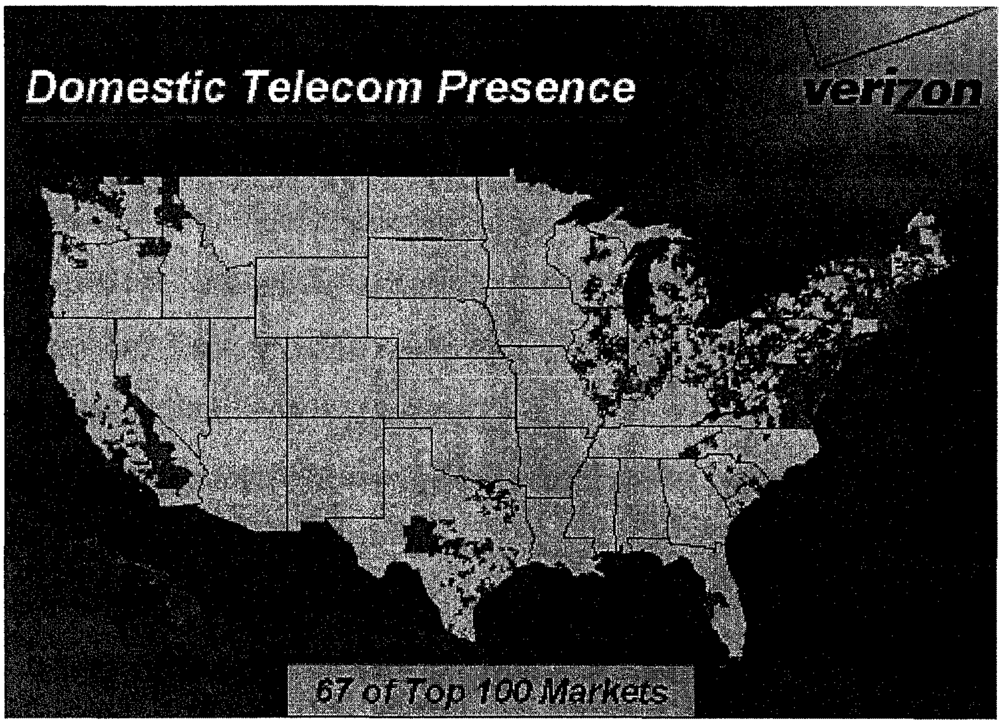
Exhibit 2

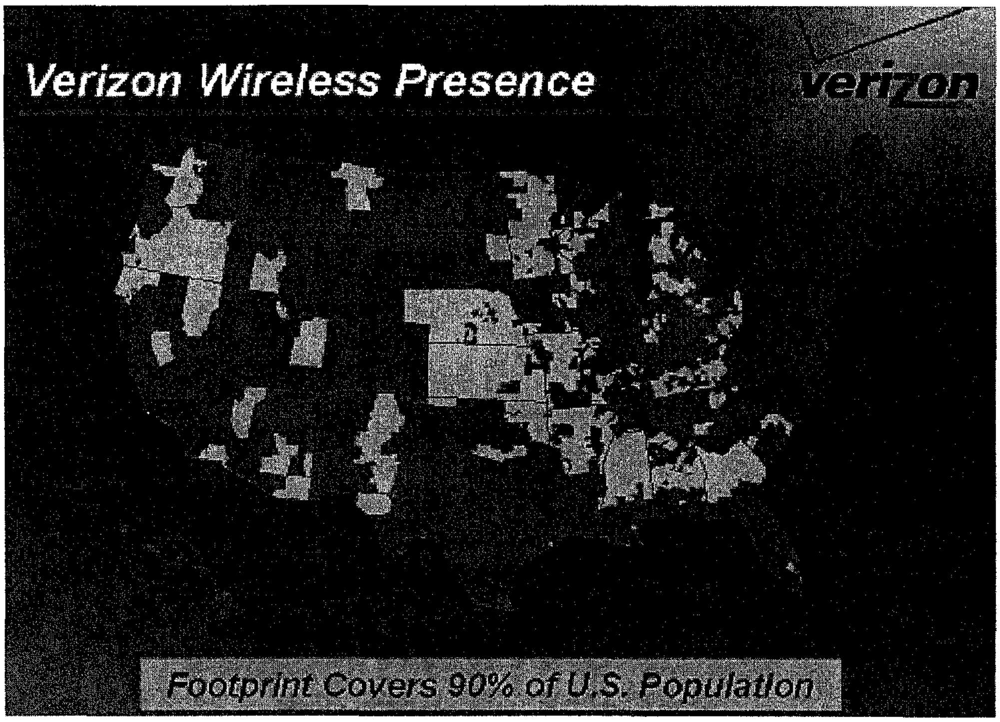
2003 Total Arizona Residence and Business Access Lines Without Verizon Wireless

REDACTED

Exhibit 3

Verizon's National Geographic Coverage





http://www22.verizon.com/about/